

SUBCHAPTER A—GENERAL

PART 2509—INTERPRETIVE BULLETINS RELATING TO THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974

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AUTHORITY: 29 U.S.C. 1135. Secretary of Labor's Order 1-2003, 68 FR 5374 (Feb. 3, 2003). Sections 2509.75-10 and 2509.75-2 issued under 29 U.S.C. 1052, 1053, 1054. Sec. 2509.75-5 also issued under 29 U.S.C. 1002. Sec. 2509.95-1 also issued under sec. 625, Pub. L. 109-280, 120 Stat. 780.

§ 2509.08-1 Supplemental guidance relating to fiduciary responsibility in considering economically targeted investments.

This Interpretive Bulletin sets forth the Department of Labor's interpretation of sections 403 and 404 of the Employee Retirement Income Security Act of 1974 (ERISA), as applied to employee benefit plan investments in "economically targeted investments," that is, investments selected for the economic benefits they create apart from their investment return to the employee benefit plan. The guidance set forth in this interpretive bulletin modifies and supersedes the guidance set forth in interpretive bulletin 94-1 (29 CFR 2509.94-1).

ERISA requires that a fiduciary act solely in the interest of the plan's participants and beneficiaries and for the exclusive purpose of providing benefits to their participants and beneficiaries. The Act specifically states, in relevant part, that:

• "[A]ssets of a plan shall never inure to the benefit of any employer and shall be held for the exclusive purposes of providing benefits to participants in the plan and their beneficiaries.* * *"¹

• "[A] fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and for the exclusive purpose of providing benefits to participants and their beneficiaries."²

ERISA's plain text thus establishes a clear rule that in the course of discharging their duties, fiduciaries may never subordinate the economic interests of the plan to unrelated objectives, and may not select investments on the basis of any factor outside the economic interest of the plan except in very limited circumstances enumerated below.

With regard to investing plan assets, the Department has issued a regulation, at 29 CFR 2550.404a-1, interpreting the prudence requirements of ERISA as they apply to the investment duties of fiduciaries of employee benefit plans. The regulation provides that the prudence requirements of section 404(a)(1)(B) are satisfied if (1) the fiduciary making an investment or engaging in an investment course of action has given appropriate consideration to those facts and circumstances that, given the scope of the fiduciary's investment duties, the fiduciary knows or should know are relevant, and (2) the fiduciary acts accordingly. This includes giving appropriate consideration to the role that the investment or investment course of

¹Sec. 403(c)(1), 29 U.S.C.A. 1103(c)(1).

²Sec. 404(a)(1)(A)(i), 29 U.S.C.A. 1104(a)(1)(A)(i).

action plays (in terms of such factors as diversification, liquidity and risk/return characteristics) with respect to that portion of the plan's investment portfolio within the scope of the fiduciary's responsibility.

Other facts and circumstances relevant to an investment or investment course of action would, in the view of the Department, include consideration of the expected return on alternative investments with similar risks available to the plan. It follows that, because every investment necessarily causes a plan to forgo other investment opportunities, an investment will not be prudent if it would be expected to provide a plan with a lower rate of return than available alternative investments with commensurate degrees of risk or is riskier than alternative available investments with commensurate rates of return.

ERISA's plain text does not permit fiduciaries to make investment decisions on the basis of any factor other than the economic interest of the plan. Situations may arise, however, in which two or more investment alternatives are of equal economic value to a plan. The Department has recognized in past guidance that under these limited circumstances, fiduciaries can choose between the investment alternatives on the basis of a factor other than the economic interest of the plan. The Department has interpreted the statute to permit this selection because (1) ERISA requires fiduciaries to invest plan assets and to make choices between investment alternatives, (2) ERISA does not itself specifically provide a basis for making the investment choice in this circumstance, and (3) the economic interests of the plan are fully protected by the fact that the available investment alternatives are, from the plan's perspective, economically indistinguishable.

Given the significance of ERISA's requirement that fiduciaries act "solely in the interest of participants and beneficiaries," the Department believes that, before selecting an economically targeted investment, fiduciaries must have first concluded that the alternative options are truly equal, taking into account a quantitative and qualitative analysis of the economic impact on the plan. ERISA's fiduciary standards expressed in sections 403 and 404 do not permit fiduciaries to select investments based on factors outside the economic interests of the plan until they have concluded, based on economic factors, that alternative investments are equal. A less rigid rule would allow fiduciaries to act on the basis of factors outside the economic interest of the plan in situations where reliance on those factors might compromise or subordinate the interests of plan participants and their beneficiaries. The Department rejects a construction of ERISA that would render the Act's tight limits on the use of plan assets illusory, and that would permit plan fiduciaries to expend

ERISA trust assets to promote myriad public policy preferences.³

A plan fiduciary's analysis is required to comply with, but is not necessarily limited to, the requirements set forth in 29 CFR 2550.404a-1(b). In evaluating the plan portfolio, as well as portions of the portfolio, the fiduciary is required to examine the level of diversification, degree of liquidity, and the potential risk/return in comparison with available alternative investments. The same type of analysis must also be applied when choosing between investment alternatives. Potential investments should be compared to other investments that would fill a similar role in the portfolio with regard to diversification, liquidity, and risk/return.

In light of the rigorous requirements established by ERISA, the Department believes that fiduciaries who rely on factors outside the economic interests of the plan in making investment choices and subsequently find their decision challenged will rarely be able to demonstrate compliance with ERISA absent a written record demonstrating that a contemporaneous economic analysis showed that the investment alternatives were of equal value.

Examples:

A plan owns an interest in a limited partnership that is considering investing in a company that competes with the plan sponsor. The fiduciaries may not replace the limited partnership investment with another investment based on this fact unless they prudently determine that a replacement investment is economically equal or superior to the limited partnership investment and would not adversely affect the plan's investment portfolio, taking into account factors including diversification, liquidity, risk and expected return. The competition of the limited partnership with the plan sponsor is a factor outside the economic interests of the plan, and thus cannot be considered unless an alternative investment is equal or superior to the limited partnership.

A multiemployer plan covering employees in a metropolitan area's construction industry wants to invest in a large loan for a construction project located in the same area because it will create local jobs. The plan has taken steps to ensure that the loan poses no prohibited transaction issues. The loan carries a return fully commensurate with the risk of nonpayment. Moreover, the loan's expected return is equal to or greater than construction loans of similar quality that are available to the plan. However, the plan

³See letters from the Department of Labor to Jonathan Hiatt dated May 3, 2005; to Thomas Donahue dated December 21, 2007 (A.O. 2007-07A); and to David Chavern dated June 27, 2008 (A.O. 2008-05A).

has already made several other loans for construction projects in the same metropolitan area, and this loan could create a risk of large losses to the plan's portfolio due to lack of diversification. The fiduciaries may not choose this investment on the basis of the local job creation factor because, due to lack of diversification, the investment is not of equal economic value to the plan.

A plan is considering an investment in a bond to finance affordable housing for people in the local community. The bond provides a return at least as favorable to the plan as other bonds with the same risk rating. However, the bond's size and lengthy duration raises a potential risk regarding the plan's ability to meet its predicted liquidity needs. Other available bonds under consideration by the plan do not pose this same risk. The return on the bond, although equal to or greater than the alternatives, would not be sufficient to offset the additional risk for the plan created by the role that this bond would play in the plan's portfolio. The plan's fiduciaries may not make this investment based on factors outside the economic interest of the plan because it is not of equal or greater economic value to other investment alternatives.

A plan sponsor adopts an investment policy that favors plan investment in companies meeting certain environmental criteria (so-called "green" companies). In carrying out the policy, the plan's fiduciaries may not simply consider investments only in green companies. They must consider all investments that meet the plan's prudent financial criteria. The fiduciaries may apply the investment policy to eliminate a company from consideration only if they appropriately determine that other available investments provide equal or better returns at the same or lower risks, and would play the same role in the plan's portfolio.

A collective investment fund, which holds assets of several plans, is designed to invest in commercial real estate constructed or renovated with union labor. Fiduciaries of plans that invest in the fund must determine that the fund's overall risk and return characteristics are as favorable, or more favorable, to the plans as other available investment alternatives that would play a similar role in their plans' portfolios. The fund's managers may select investments constructed or improved with union labor, after an economic analysis indicates that these investment options are equal or superior to their alternatives. The managers will best be able to justify their investment choice by recording their analysis in writing. However, if real estate investments that satisfy both ERISA's fiduciary requirements and the union labor criterion are unavailable, the fund managers may have to select invest-

ments without regard to the union labor criterion.

[73 FR 61735, Oct. 17, 2008]

§ 2509.08-2 Interpretive bulletin relating to the exercise of shareholder rights and written statements of investment policy, including proxy voting policies or guidelines.

This interpretive bulletin sets forth the Department of Labor's (the Department) interpretation of sections 402, 403 and 404 of the Employee Retirement Income Security Act of 1974 (ERISA) as those sections apply to voting of proxies on securities held in employee benefit plan investment portfolios and the maintenance of and compliance with statements of investment policy, including proxy voting policy. In addition, this interpretive bulletin provides guidance on the appropriateness under ERISA of active monitoring of corporate management by plan fiduciaries. The guidance set forth in this interpretive bulletin modifies and supersedes the guidance set forth in interpretive bulletin 94-2 (29 CFR 2509.94-2).

(1) Proxy Voting

The fiduciary act of managing plan assets that are shares of corporate stock includes the management of voting rights appurtenant to those shares of stock.¹ As a result, the responsibility for voting or deciding not to vote proxies lies exclusively with the plan trustee except to the extent that either (1) the trustee is subject to the direction of a named fiduciary pursuant to ERISA Sec. 403(a)(1); or (2) the power to manage, acquire or dispose of the relevant assets has been delegated by a named fiduciary to one or more investment managers pursuant to ERISA Sec. 403(a)(2). Where the authority to manage plan assets has been delegated to an investment manager pursuant to Sec. 403(a)(2), no person other than the investment manager has authority to make voting decisions for proxies appurtenant to such plan assets except to the extent that the named fiduciary has reserved to itself (or to another named fiduciary so authorized by the plan document) the right to direct a plan trustee regarding the voting of proxies. In this regard, a named fiduciary, in delegating investment management authority to an investment manager, could reserve to itself the right to direct a trustee with respect to the voting of all proxies or reserve to itself the right to direct a trustee as to the voting

¹See letter from the Department of Labor to Helmut Fandl, Chairman of the Retirement Board of Avon Products, Inc., dated February 23, 1988.